DO NON-REPRESENTATION PROVISIONS REALLY WORK?

COUNSEL'S CORNER

My son Jon Lautin is in law school at Boston University. He wrote this, and it is reprinted here with his permission.

Fraud is bad, and courts don't like it.

Franceso Secchi and his wife Jane Secchi opened a restaurant called Italian Cowboy in Keystone Shopping Center, in Dallas. The land and building was owned by Prudential Insurance Company and had been previously leased to Hudson's Grill. Evidently Hudson's struggled to pay rent, and vacated.

The lease contained two clauses relevant to a claim later asserted by M/M Secchi: the first stated that the Secchis did not rely on any representations by Prudential except those stated in the lease (a "*Merger*" clause). The second contained an "*Entire Agreement*" clause stating that the lease constitutes the entire agreement and no changes are binding unless signed by both parties.

Before signing the lease the Secchis were assured by agents of the landlord that the building was new, had no problems, was in "perfect condition" and that the previous tenant had no issues with the building. However, immediately after moving in the Secchis noticed that there was a sewer stink permeating the building. After some investigating they discovered that the grease trap was improperly installed which caused the terrible smell.

Both the Secchis and Prudential attempted to fix the problem but were unsuccessful. Before Italian Cowboy was scheduled to open for business, the Secchis realized that the smell prevented the possibility of a successful restaurant. They stopped

paying rent and sued Prudential for fraud and negligent misrepresentation. Prudential counterclaimed for breach of contract since the Secchis stopped paying rent.

Numerous facts allowed the Secchis to win approximately $600,000 in damages in trial court. The previous tenants of the building, also owners of a restaurant, notified Prudential of the foul smell long before the Secchis started lease negotiations. Nonetheless, the defendants claimed that they were not aware of the stench when confronted by the Secchis. Prudential reassured the Secchis numerous times before signing the lease that the building was in perfect condition. These statements, determined to be false in the trial court, were enough to prove fraud and negligent misrepresentation.

Or so the Secchis thought.

The Texas Court of Appeals disagreed and held that the lease barred claims for fraud and negligent misrepresentation. The Court of Appeals stated that not all "*Representation*" clauses bar fraud and negligent misrepresentation claims unless it is clear that both parties intend the clause to be binding. Reverting back to a fundamental principal of American contract law, the Court of Appeals decided that both the plaintiff and defendant had a "meeting of the minds" to bar all fraud claims. Furthermore, the Appellate Court held that there could be no fraud and negligent misrepresentation because the parties were experienced businesspeople and they had competent attorneys negotiating the contract. Therefore, the merger clause is binding since the evidence suggests the parties meant it to be binding.

Or so Prudential thought.

The Supreme Court of Texas reversed the Court of Appeals' decision. The Supreme Court held that the language of the "*Representation*" and "*Merger*" clauses did not show intent to bar allegations of fraud and negligent misrepresentation. The Court further explained that even if the parties intended to release all claims of fraud, the clauses in the contract did not contain "clear and unequivocal language" to that effect.

The ruling in this case may indicate a change in direction for the Supreme Court of Texas. In a landmark case in 1997, Schulumberger Technology Corp. v. Swanson, the Court held that a particular contract with a similar "*Representation*" clause effectively barred all claims of fraud. While there are differences between the facts of the two cases, the Texas Supreme Court's willingness to hear the Italian Cowboy case and its decision that fraud was not barred could show that Texas is following other states and taking a hard-line stance on fraud.

See *Italian Cowboy Partners, Ltd. v. The Prudential Insurance Company of America*; No. 08-0989; Supreme Court of Texas; April 15, 2011.

Lessons learned:

1. Courts will usually allow a party to stop performing their obligations under a contract if that party was fraudulently induced into entering the contract.

2. Including clauses that appear to bar fraud claims may not be sufficient to bar fraud claims.

3. Courts, like juries, can be unpredictable.

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